

COMMISSIONERS

**ORDER TO CEASE AND DESIST, ORDER
FOR ADMINISTRATIVE PENALTIES AND
CONSENT TO SAME
BY: J.P. MORGAN SECURITIES INC.**

WHEREAS, JPMSI agrees to implement certain changes with respect to its research practices,
and to make certain payments; and

1 NOW, THEREFORE, the Arizona Corporation Commission (“Commission”) hereby enters
2 this Order:

3 JPMSI elects to permanently waive any right to a hearing and appeal under Articles 11 and 12
4 of the Securities Act of Arizona, A.R.S. §44-1801 *et seq.* (“Securities Act”) and Title 14 of the
5 Arizona Administrative Code with respect to this Order To Cease and Desist and Order for
6 Administrative Penalties (“Order”); neither admits nor denies the Findings of Fact and Conclusions
7 of Law contained in this Order, and consents to the entry of this Order by the Commission.

8 **I.**

9 **FINDINGS OF FACT**

- 10 1. This action concerns the period of July 1, 1999 to June 30, 2001 (the “relevant period”).
11 During that time, several JPMSI predecessor entities engaged in both research and
12 investment banking (“IB”) activities.
- 13 2. Respondent JPMSI is a subsidiary of J.P. Morgan Chase & Co. (“JPMC”), a Delaware
14 corporation with its principal place of business in New York, New York. Respondent
15 JPMSI provides equity research, sales, and trading services; merger and acquisition
16 advisory services; private banking services; and underwriting services.
- 17 3. Hambrecht & Quist LLC (“H&Q”) engaged in research and IB activities until it was
18 acquired by The Chase Manhattan Corporation (“Chase”) in December 1999. H&Q was
19 merged into Chase Securities Inc. (“CSI”), a subsidiary of Chase, and the merged entity
20 engaged in research and IB activities under the name CSI and the trade name Chase H&Q.
21 CSI did not publish equity research prior to the acquisition of H&Q by Chase.
- 22 4. In 1999, RESPONDENT JPMSI engaged in both research and IB activities as a subsidiary
23 of J.P. Morgan & Co. Incorporated (“JPM”). In December 2000, Chase acquired JPM,
24 creating the combined entity JPMC. In May 2001, CSI and RESPONDENT JPMSI
25 merged, and CSI assumed the name JPMSI. Since then, RESPONDENT JPMSI has
26

- 1 engaged in equity research under the name JPMSI and the trade names J.P. Morgan and J.P.
2 Morgan H&Q.
- 3 5. RESPONDENT JPMSI is registered with the Securities and Exchange Commission
4 (“Commission”), is a member of the New York Stock Exchange and NASD, and is licensed
5 to conduct securities business on a nationwide basis.
- 6 6. For purposes of this Consent, the RESPONDENT JPMSI predecessor entities that engaged
7 in both research and investment banking activities—H&Q, CSI, and JPMSI—shall be
8 referred to, collectively, individually, or in any combination, as “the Firm.”

9 **B. Overview**

- 10 1. During the relevant period, the Firm sought to do and did IB business with many companies
11 covered by its Research Department. Research analysts were encouraged to participate in
12 IB activities, and this participation was a factor used by the Firm to evaluate analysts and
13 determine their compensation. In addition, the decision to initiate and maintain research
14 coverage on certain companies was coordinated with the IB Department and influenced by
15 IB interests.
- 16 2. As a result of the foregoing, certain research analysts were subject to IB influences and
17 conflicts of interest between supporting the Firm’s IB business and publishing objective
18 research.
- 19 3. The Firm had knowledge of these IB influences and conflicts of interest yet failed to
20 establish and maintain adequate policies, systems, and procedures reasonably designed to
21 detect and prevent the influences or manage the conflicts.

22 **C. Research Analyst Participation in Investment Banking Activities**

- 23 1. Research analysts were responsible for providing analyses of the financial outlook of
24 particular companies in the context of the business sectors in which those companies
25 operated and the securities market as a whole.
- 26

2. Research analysts evaluated companies by, among other things, examining financial and other information contained in public filings; questioning company management; investigating customer and supplier relationships; evaluating companies' business plans and the products or services offered; building financial models; and analyzing competitive trends.
3. After synthesizing and analyzing this information, research analysts drafted research reports and more abbreviated "notes" that typically contained a recommendation, a price target, and a summary and analysis of the factors upon which the analyst relied in issuing the price target and recommendation.
4. The Firm published research on publicly traded companies, and this research was distributed to the Firm's institutional and private equity customers. Published research was made available through mailing lists, the Firm's website, and subscription services provided by First Call. In addition, the research was made available to some retail customers of another broker dealer and offered via websites offering brokerage and investment services.
5. In addition to performing these research functions, certain research analysts participated in IB activities.
6. These IB activities included identifying and/or vetting companies as prospects for IB services, participating in pitches of IB services to companies, participating in "roadshows" associated with underwriting transactions, and speaking to investors to generate interest in underwriting transactions.¹
7. These IB activities also included participating in commitment committee and due diligence activities in connection with underwriting transactions and assisting the IB

¹ A "roadshow" is a series of presentations made to potential investors in conjunction with the marketing of an upcoming underwriting.

1 Department in providing merger and acquisition (“M&A”) and other advisory services to
2 companies.²

3 8. The Firm encouraged all research analysts to support its businesses, including the Firm’s
4 IB business, and in some cases, research analysts were expected to participate in the
5 foregoing IB activities. The level of analyst participation in these IB activities was
6 sometimes significant.

7 9. For example, in an e-mail dated May 23, 2000, and sent by a research analyst to the Head
8 of Research at RESPONDENT JPMSI, the analyst requested approval to hire another
9 junior analyst. The analyst stated: **‘I’d like to get yet another junior....**The deals are
10 really dragging me down, and I’m not spending nearly enough time with buy-side clients.
11 Even though the market is crap, we continue to process deals in hopes of market
12 recovery....I am trying to remove myself from the day-to-day production of research. I
13 actually like doing it, but it’s not what you pay me for.” (Emphasis in the original.)

14 10. IB business was an important source of revenue for the Firm. In 2000, the combined
15 operating revenues for JPM and Chase totaled \$32.793 billion, and the combined
16 revenues for the Equity Capital Markets (“ECM”) and the M&A Departments at JPM and
17 Chase totaled \$1.687 billion.

18 **D. Participation in Investment Banking Activities Was a Factor in Evaluating and**
19 **Compensating Research Analysts**

- 20 1. The compensation system at the Firm provided an incentive for research analysts to
21 participate in IB activities and to assist in generating IB business for the Firm.
- 22 2. The performance of research analysts was evaluated by the Head of Research through an
23 annual review process and, where not set by contract in advance, the research analyst’s
24 bonus was determined through this process.

25 _____
26 ² The “commitment committee” was responsible for, among other things, evaluating and then either approving or
rejecting the Firm’s participation in initial public offerings (“IPOs”) and other IB transactions.

- 1 3. The Head of Research evaluated the research analysts' job performance through
2 responses to self-evaluation forms; surveys of the sales force; input from the IB, Sales,
3 and Trading departments; consideration of market factors and rankings by investor
4 publications; and, in some cases, written "team reviews" submitted by individual
5 investment bankers.
- 6 4. The self-evaluation forms contained questions on areas constituting the major allocations
7 of research analysts' time, including questions relating to participation in IB activities.
- 8 5. In response to questions relating to participation in IB activities, research analysts
9 reported one or more of the following: their IB activities, accomplishments, and goals;
10 their participation in lead- and co-managed underwritings; and the fees associated with IB
11 transactions on which the analyst worked.
- 12 6. For example, the "Investment Banking Activities" section of a 1999 self-evaluation form
13 queried: "In what way have you assisted in discovering or executing banking
14 transactions (i.e., due diligence sessions, pitches)? Be specific." In response, a research
15 analyst stated: "Helped put together and develop pitch books for KV Pharma and King
16 Pharmaceuticals;" "Helping to come up with creative ideas and contributing to
17 brainstorming sessions with bankers – ad hoc and in biweekly Monday meetings;" "Have
18 a good handle on which companies will need financing in the near future and stepping up
19 research efforts to ensure a place for H&Q on the cover;" and "Increasing responsibility
20 in the office allows [another research analyst] to travel and be more active in pitching and
21 winning deals with new companies."
- 22 7. In another example, a research analyst stated the following in response to IB questions
23 contained in his year 2000 self-evaluation form: "Completed 21 investment banking
24 deals, including 11 lead-managed deals....Biotechnology new issues have generated \$70
25 million in primary fees in fiscal year 2000 YTD. In 2000 we were ranked #1 in
26 healthcare common equity offerings by U.S. Issuers, raising \$3.9 billion and capturing

21.9% market share.” In addition, the analyst listed all deals on which he worked that were “Lead Managed,” “Co-managed,” “Pitched,” and “Pending.”

8. The self-evaluation forms conveyed to research analysts some of the criteria used to evaluate their performance. As reflected in the IB questions contained in the forms, contribution to the Firm’s IB business was an important part of the analyst’s job.
9. In some circumstances, research analysts requested that individual investment bankers complete a written “team review” of the analyst, which was then submitted to the Head of Research. In these reviews, the investment banker described his or her contact with the analyst and the analyst’s participation in IB activities, including pitch and underwriting activities.
10. For example, in a 1999 review of a research analyst by an investment banker, the banker stated the following: “I have worked extensively with [this research analyst] over the past year. I probably speak to her everyday [sic] on topics ranging from executing live transactions, evaluating potential business opportunities, drafting ‘pitch’ presentations, coordinating scheduling and marketing efforts across IB, and strategizing about the Internet practice....I consider [her] to be a partner in our building of the firm’s Internet franchise and, as a result, probably work more closely with her than anyone in IB.”
11. Research analysts sometimes provided reviews of investment bankers in conjunction with the banker’s performance review. In these reviews, analysts described their contact with the banker and referenced participation in specific IB activities.
12. For example, in an e-mail dated Dec. 14, 2000, a research analyst provided a review of an investment banker. The analyst stated: “I’ve probably had more opportunity to work with [this investment banker] and observe him in action than anybody else in the bank....[The banker and I] have been in sync about where the quality banking prospects are so that I don’t have to fend off garbage banking deals....• **Built semiconductor banking practice from nothing:....**[The banker and I] have built a profitable

1 semiconductor banking practice, starting from literally zero four years ago....In 1999, we
2 posted a couple of successes....With a touch more luck, we could have doubled the
3 revenue potential this year....We are still banking the semiconductor sector pretty much
4 the way we did three years ago, which means going after a dozen or so key prospects
5 (split evenly between existing public companies and quality IPO candidates) and then
6 doing everything else opportunistically rather than strategically....The message here is
7 that we have not developed the semiconductor banking machine that our strongest dozen
8 competitors have, and that makes it hard to gain market share.” (Emphasis in the
9 original.)

- 10 13. Based upon comments in the self-evaluations completed by research analysts and the
11 reviews completed by both analysts and investment bankers, the two groups worked
12 closely on IB transactions and shared a common goal of building the Firm’s IB business.
- 13 14. The Head of Research reviewed the self-evaluations and team reviews and provided a
14 verbal and/or written evaluation of the research analyst. The written evaluations
15 provided feedback on the analyst’s performance during the year and in certain cases
16 highlighted the analyst’s participation in IB activities, including the revenues generated
17 by IB transactions on which the analyst worked.
- 18 15. For example, the Head of Research at RESPONDENT JPMSI stated the following in the
19 first paragraph of his year 2000 evaluation of a research analyst: “By every measure, [the
20 research analyst] had an outstanding year in 2000. Most importantly, [he] led the charge
21 in establishing J.P. Morgan as the #1 biotech shop with a resounding 21.9% share of the
22 underwriting wallet in his sector. [He] supported 21 transactions this year, 11 of which
23 were as the lead underwriter. The revenue attributable to these transactions is over \$70
24 mm.” Later in the evaluation, the Head of Research stated that the analyst’s contribution
25 to the Firm’s “corporate underwriting business” was “enormous.”
26

- 1 16. Comments by the Head of Research conveyed to research analysts the performance areas
2 that were important to research management and the Firm. Based upon these comments,
3 certain analysts were encouraged to participate in IB activities, increase IB revenues, and
4 enhance the reputation of the Firm's IB franchise.
- 5 17. Research analyst bonuses were determined by the Head of Research in his discretion after
6 considering several factors that contributed to the analyst's market value.
- 7 18. The research analyst's contribution to and impact on the Firm's IB business, and the fees
8 generated by IB transactions on which the analyst worked, were some of the factors used
9 to determine the analyst's bonus. If the analyst did not disclose in the self- evaluation
10 form the fees generated by the IB transactions on which he or she worked, the Head of
11 Research requested this information from the ECM Department at the Firm.

12 **E. Investment Banking Interests Influenced the Firm's Decision to Initiate and Maintain**
13 **Research Coverage**

- 14 1. In general, the Firm determined whether to initiate and maintain research coverage based
15 upon institutional investors' interest in the company and/or based upon IB considerations,
16 such as attracting companies to generate IB business or maintaining a positive
17 relationship with existing IB clients.
- 18 2. Regarding companies for which the Firm lead- or co-managed an underwriting
19 transaction, research coverage was typically initiated and maintained for a period of time
20 beyond the transaction.
- 21 3. The Head of Research was responsible for approval of the determination to issue,
22 maintain, and drop research coverage. The Head of Research solicited input from other
23 departments, including the IB Department, to determine the coverage preferences of
24 those departments. IB considerations sometimes played a role in the decision to initiate
25 and maintain research coverage.
26

- 1 4. For example, after the merger of JPM and Chase, the Director of U.S. Equity Research at
2 RESPONDENT JPMSI sent an e-mail entitled: "U.S. Equity Research Organizational
3 Announcement." Attached was an internal memorandum "outlining Investment Banking
4 Coordination Responsibilities," which stated: "One of the important duties of the
5 Director of Research is to work closely with Investment Banking to ensure that research
6 resources are appropriately aligned with identified investment banking opportunities."
- 7 5. In addition, the Head of Research requested that research analysts obtain from investment
8 bankers lists of companies that the bankers wanted under coverage.
- 9 6. For example, an e-mail dated November 4, 1999, from the Head of Research to all equity
10 research analysts, stated: "[T]alk to your counterparts in IB and prepare a list of the
11 companies that they would like you to cover....Please be sure to have a conversation with
12 the appropriate bankers before you submit your list."
- 13 7. Some research analysts and investment bankers actively coordinated the initiation and
14 maintenance of research coverage based upon, among other things, IB considerations.
15 This coordination consisted of meetings and communications by telephone and e-mail.
- 16 8. For example, a research analyst sent an e-mail, dated March 9, 2001, to the Director of
17 U.S. Equity Research at RESPONDENT JPMSI which stated: "[Another research
18 analyst] and I have prioritized the coverage area in coordination with banking, and we are
19 moving to a more **targeted** (no pun intended) investor marketing plan which leverages
20 our combined coverage....We are clearly focused on building both the brokerage and
21 banking businesses....We are actively discussing trimming a couple of the less relevant
22 of these companies and replacing them with larger market capitalization firms which we
23 can bank....In total, I would look to us to initiate on **two** non-deal related stocks this year,
24 keeping the total names under coverage around the current level. In addition to two non-
25 deal initiations, we have mapped out the year and have planned original theme pieces and
26 other value-added activities for investors including non-deal related road

1 shows....**Banking:** We already did KPMG, for which I believe we were paid **\$12.5M**.
2 And we have been mandated as a senior co-manager on Accenture, another large
3 transaction. Beyond these, a likely opportunity later in the year is **Technology Partners**
4 **International**, an outsourcing consultant. We are well positioned to lead this company's
5 IPO....[An investment banker] leads the coordinated banking effort covering the sector,
6 and we are working closely with [him] and the other coverage bankers to bank existing
7 companies and to identify quality early stage firms." (Emphasis in the original.)

- 8 9. In another example, an investment banker sent an e-mail, dated May 17, 2001, to a group
9 of biotechnology analysts and bankers to arrange a meeting to discuss "coverage
10 strategy." The e-mail stated: "On the heels of [a research analyst and a banker] leaving,
11 we probably need to discuss coverage strategy. Also would be a good time to talk about
12 where we might shake loose some business...M&A ideas to pitch, IPOs coming in next
13 wave etc."
- 14 10. In another example, a research analyst sent an e-mail, dated March 1, 2001, to
15 biotechnology analysts and the Head of U.S. Equity Research that contained the
16 following subject line: "bankers wish list for biotech research." The e-mail stated:
17 Attached is the culmination of the survey of bankers – as a reminder, I asked them for 3
18 groups of names....1. Companies we 'owe' research to since they paid us in 2000 and
19 are not covered by research today. Most of these are from analysts who have left (on the
20 H&Q side) and we haven't even had research take a formal look at some of these, which
21 is obviously the first step for deciding on what to do. 2. Public companies where
22 bankers have a good relationship and think we can get banking business if research is on
23 board. The goal here is to have research evaluate the story as soon as possible, so we can
24 either go full bore on getting the business, or re-assign bankers elsewhere if research is
25 negative. 3. Private companies that are focus names—we'll commit to have research
26 spend time with these companies as much as possible before the IPO to put us in the best

1 position possible to win the books. Also, research is going to add their own names if
2 some of their favorites were not mentioned by any of the bankers.”

3 11. The following e-mails reflect the IB influences in the initiation and maintenance of
4 research coverage as perceived by an individual research analyst.

5 12. In an e-mail dated November 2, 2000, a research analyst provided a team review of an
6 investment banker that stated the following: “I have worked with [the banker] on the
7 International Rectifier (IRF) account since around mid-1998...and he lobbied me very
8 actively to pick up coverage so that JPM could go after the banking business, especially
9 equities but also potentially debt, M&A, etc. My attitude initially was that IRF is a low-
10 grade semiconductor company that would be hard to sell to buy-side clients, but [he] kept
11 pushing the banking potential....Finally, I picked up coverage in December 1998....
12 Then, IRF threw sand in our eyes by giving the lead to Morgan Stanley....We picked up
13 coverage when they needed us most at the bottom of the semiconductor cycle and
14 supported the stock enormously. When the plum banking assignment came up that would
15 pay us back for our support, IRF handed the deal to MS, which had zero history with the
16 company.”

17 13. In an e-mail dated August 8, 2000, the same research analyst stated: “Given how
18 thoroughly we just got screwed on IRF, [the Head of Research of RESPONDENT
19 JPMSI] is not interested in hearing stories about how if we initiate coverage, then we will
20 be **considered** for banking business. He wants to hear that the banking business is locked
21 up. We’ve been screwed too many times....[O]ur not covering IFX [Infineon
22 Technologies] is a direct result of being offered money-losing table scraps in the IPO....I
23 guess I’m still in the same old place. Initiating coverage of IFX some time in the next six
24 months is no problem, especially as [a research analyst] is going to have to cover it
25 eventually anyway. It doesn’t make sense to have a European semiconductor analyst that
26 does not cover Infineon.” (Emphasis in the original.)

14. In addition, consideration of “investment banking sensitivities” was included in a discussion of the Firm’s “Long Term Buy” (“LTB”) research rating.
15. An e-mail dated December 29, 2000, which was sent to all Chase H&Q research analysts, including the Head of Research at Chase H&Q, described the stock rating system to be used after the merger of JPM and Chase.
16. The e-mail’s subject line stated: “Public dissemination of coverage and Re-Rating your stocks—IMPORTANT*****.” The e-mail stated: **The guidelines for determining the rating are below.... Long-Term Buy: 0-10% outperformance of the relevant benchmark target within a twelve to eighteen month time frame. Shorter-term catalysts to explain the ‘longer-term’ nature of the recommendation, or in certain circumstances investment banking sensitivities, are appropriate for this designation.”** (Emphasis in the original.)

F. The Firm Provided Certain Companies With an Informal “Warranty” of Research Coverage in Conjunction With Investment Banking Transactions

1. The Firm typically initiated research coverage on companies that engaged the Firm in an IB transaction.
2. H&Q and Chase H&Q had an informal policy of providing certain companies with a “warranty” of research coverage in conjunction with IB transactions.
3. For example, in an e-mail dated November 22, 2000, and sent by the Head of eBusiness at Chase H&Q to the Head of Research at Chase H&Q and others, the Head of eBusiness stated the following: “I think that it is important to guaranty [sic] some level of consistent coverage for our fee paying IB clients. In terms of a ‘warranty period,’ I think that a period of 18 months would be a fair and appropriate coverage period, as well as a reasonable timeframe for a company to show progress and perhaps ‘earn’ an extension of coverage. During this transition period...we could offer more of a general, maintenance-only, ‘no name’ research coverage...[that] could be done by a ‘team’ of junior associates

from both the IB and research side of the house as part of the ‘pod’ approach to a sector. This coverage would allow the pod to continue to maintain a relationship with the company, generating additional income from the account.”

4. The Firm verbally promoted this warranty research coverage in conjunction with pitches of IB business to companies, and research coverage would be maintained on certain companies subject to the warranty.
5. For example, in an e-mail dated October 20, 1999, an investment banker sent an e-mail to senior executives at H&Q that contained the following subject line: “Follow Up on a Pitch Please.” The e-mail stated: [Head of IB:] Please call...[the] Chairman of CCC Info. Services....Script: You know that [a team of investment bankers] presented to the board yesterday and that we are very excited about the prospect of serving as agent for a private round with financial and strategic parties and as lead manager on their IPO in early 00....Our pitch is...4. Best aftermarket ‘warranty.’”
6. Also, in an e-mail dated December 19, 2000, from an investment banker to a member of the board of directors of Epicor Software Corporation (“Epicor”), the banker stated: “Just a heads up that the extended warranty provided for Epicor is running out.” In an e-mail dated December 22, 2000, the board member replied: “not a surprise. thanks for sticking to the deal.”

G. The Firm’s Pitch Materials Contained Discussions of Research Coverage

1. During the relevant period, companies considered research coverage to be an important factor in selecting a firm for an underwriting transaction.
2. In certain pitch materials, the Research Department, and research analysts in particular, were described to implicitly suggest that the Firm would provide favorable research coverage after the IB transaction.³ The research analyst’s reputation and industry

³ “Pitch materials” are the written materials provided to the management of an issuer in conjunction with the Firm’s pitch or presentation of its strengths and capabilities in conducting an upcoming IPO or other IB transaction.

1 ranking, statistics regarding the percentage of lead- and co-managed IPOs currently under
 2 coverage, and the Firm's "aftermarket support" were promoted in pitch materials. In
 3 addition, the Firm utilized "case studies" of companies under coverage that included
 4 charts comparing the dates of positive published research to the company's stock price.
 5 The case studies showed the stock price increases following the analyst's positive
 6 recommendation and/or placement on the analyst's or the Firm's "Focus Lists."

7 3. For example, in an e-mail dated February 23, 2000, an investment banker forwarded pitch
 8 materials to an employee of Participate.com to persuade the company to employ the Firm
 9 as an underwriter for an upcoming IPO and private offering. The pitch materials
 10 identified the research analyst who would cover the company after the IB transaction. In
 11 pages captioned "[Research analyst's name]: Authoritative Voice in the Marketplace,"
 12 "case studies" were presented on the analyst's past coverage of two companies: Wireless
 13 Facilities and AppNet.

14 4. The case studies contained charts that showed the stock price increases following
 15 placement of the stocks on the analyst's and Firm's focus lists. The "Wireless Facilities
 16 Case Study" stated the following: "Chase H&Q adds WFI to Focus List: WFI gains
 17 11.7% (1/27/00)." The "AppNet Case Study" stated the following: "Chase H&Q adds
 18 AppNet to Focus List: AppNet gains 7.5% (8/2/99)....While on [the research analyst's]
 19 Focus List, AppNet appreciates 309% (8/2/99-10/26/99)."

20 5. Also presented were excerpts of positive commentary by the research analyst that
 21 accompanied the Buy ratings and/or placement on the focus lists.

22 **H. Research Analysts Were Visible on Stocks to Generate Investment Banking Business**

23 1. Research analysts were encouraged to increase their visibility, or level of communication,
 24 on certain stocks to generate IB business.

25 2. Lists of stocks were distributed to various departments at the Firm, including the
 26 Research Department.

- 1 3. The “ECM [Equity Capital Markets] target list” contained stocks of companies from
2 which the Firm was seeking IB business during the next eighteen (18) months.
- 3 4. The “trading focus list” contained stocks of companies from which the Firm was seeking
4 IB or underwriting business during the next three months.
- 5 5. The Research Department and other departments were at times encouraged to increase
6 the trading volume of the stocks on the lists for IB purposes.
- 7 6. The following e-mail, dated May 11, 2001, and sent from an investment banker to
8 individuals on the “IB Ebusiness” distribution list, explains the rationale for the two lists:
9 “The criteria for being on the [ECM target] list is...potential equity business over the
10 next 18 months where we would like to target the resources of the firm to win the
11 books....Our objective is to make sure we are being as proactive as possible from an
12 equity perspective, and focusing the equity resources of the firm on these targets to help
13 you win the books for these transactions....The criteria for being placed on the trading
14 focus list is an investment banking event with [sic] the NEXT THREE MONTHS....This
15 investment banking list could be an m&a event or an equity event....In cases where the
16 investment banking event will occur far in advance, our first approach is to work with the
17 traders, analysts and sales traders to increase our trading activity naturally, before we
18 start spending the firm’s capital.” (Emphasis in the original.)
- 19 7. Trading rank was important to a company’s choice of a firm for IB transactions, and the
20 Firm’s trading rank was often promoted in pitch materials provided to potential IB
21 clients.
- 22 8. For example, pitch materials provided in conjunction with the AppNet IPO contained a
23 section entitled, “Commitment to Corporate Clients Delivers Institutional Credibility and
24 Trading Strength.” There, H&Q’s Autex trading rank is identified as “#1,” “#2,” “#3,”
25 and “#4” in the stocks of specific companies that engaged H&Q for an IPO.
- 26

- 1 9. Certain research analysts were encouraged to increase their visibility, or level of
2 communication, on stocks contained in the lists.
- 3 10. For example, in an e-mail dated September 27, 2000, from an investment banker, to a
4 research analyst and others, the banker forwarded September's focus list and stated:
5 "The list is okay but we are falling way short on a few names. Vicinity we are not AT
6 [sic] the goal, we are below the goal for the past two months. This is a problem. On
7 Intertrust and Mypoints, we are not even close to our targets. Less critical, but we need
8 to do a better job. Concord EFS paid us \$5 MM last year and we are the #18 trader of
9 that stock. Also disappointing...[Y]ou [research analyst] need to get more visible on
10 these names with the salespeople so that trading doesn't have that excuse to hide behind."

11 **I. Payments for Research**

- 12 1. During the relevant period, H&Q and Chase H&Q made seven payments totaling
13 \$1,312,500 for research issued in conjunction with five underwriting transactions in
14 which the Firm was a lead- or co-manager.
- 15 2. H&Q and Chase H&Q made these payments for research without disclosing or ensuring
16 their disclosure in offering documents or elsewhere.

17 **J. The Firm Failed to Adequately Supervise Its Research and Investment Banking**

18 **Departments**

- 19 1. While the role of research analysts was to produce objective research, the Firm also
20 encouraged them to participate in IB activities.
- 21 2. In addition, the Research and IB Departments had a formal connection within the Firm's
22 organizational structure. From February to December 2000 at RESPONDENT JPMSI,
23 the Head of Research had a dual reporting line to both the Head of Equities and the Head
24 of Investment Banking.
- 25 3. Also, in 2000 at Chase H&Q, research analysts were organized and placed into "Analyst
26 Sub-pods" for purposes of managing and monitoring their IB activities. Research

analysts reported to “Sub-pod Managers,” who were investment bankers and were responsible for the day-to-day coordination of the research analysts’ IB activities.

4. The Analyst Sub-pod system for Chase H&Q “Internet Research and Banking” is explained in a May 2000 Chase H&Q interoffice memorandum which contained a “coordination chart.” In the chart, the Analyst Sub-pods had a direct reporting line to the Sub-pod Managers. The memorandum stated the following: “The ‘Analyst Sub-pod’ is the organizational engine for all that we do.” Sub-pod Managers, who were investment bankers, were responsible for the “pipeline management and...the day-to-day coordination of the particular analyst as it relates to investment banking activity....The Sub-pod Manager is not responsible for executing all of that particular analyst’s transactions, but is responsible for ensuring that appropriate resources are allocated. As such, the Sub-pod Manager should expect to spend a majority of his time banking the Sub-pod Analyst with the balance of his time spent banking other analysts as the demands of the business require it.” (Emphasis in the original.)
5. The Analyst Sub-pod system was created to provide “enhanced coordination between Banking and Research.”
6. As a result of the foregoing, research analysts were subject to IB influences and conflicts of interest between supporting the Firm’s IB business and publishing objective research. The Firm had knowledge of these IB influences and conflicts of interest yet failed to manage them adequately to protect the objectivity of published research.
7. The Firm failed to establish and maintain adequate policies, systems, and procedures reasonably designed to ensure the objectivity of its published research. Although the Firm had some policies governing research analysts’ activities during the relevant period, these policies were inadequate and did not address the IB influences and conflicts of interest that existed.

II.**CONCLUSIONS OF LAW**

1. The Commission has jurisdiction over this matter pursuant to Article XV of the Arizona Constitution and the Securities Act.
2. JPMSI violated A.R.S. §44-1961(A)(13) by:
 - i. failing to establish and enforce written supervisory procedures reasonably designed to ensure that analysts were not unduly influenced by investment banking concerns;
 - ii. engaging in acts and practices that created or maintained inappropriate influence by the IB Department over research analysts, therefore imposing conflicts of interest on its research analysts, and failing to manage these conflicts in an adequate or appropriate manner; and
 - iii. making payments for research to other broker-dealers not involved in an underwriting transaction when JPMSI knew that these payments were made, at least in part, for research coverage, and by failing to disclose or cause to be disclosed in offering documents or elsewhere the fact of such payments.
3. JPMSI's conduct is grounds for administrative penalties under A.R.S. § 44-1961(B)(1).
4. JPMSI's conduct is grounds for a cease and desist order pursuant to A.R.S. § 44-1961(B)(2).
5. JPMSI's conduct is grounds for an order requiring JPMSI to take affirmative action to correct the conditions and practices giving rise to this action pursuant to A.R.S. § 44-1961(B)(3).

III.**ORDER**

On the basis of the Findings of Fact, Conclusions of Law, and JPMSI's consent to the entry of this Order, for the sole purpose of settling this matter, prior to a hearing and without admitting or denying any of the Findings of Fact or Conclusions of Law, the Commission finds that the following relief is appropriate, in the public interest, and necessary for the protection of investors.

1 THEREFORE, IT IS HEREBY ORDERED:

2 1. This Order concludes the investigation by the Commission and any other action that the
3 Commission could commence under applicable Arizona law on behalf of Arizona as it relates to
4 JPMSI, relating to certain research practices at JPMSI described herein.

5 2. Pursuant to A.R.S. § 44-1961(B)(2) and (3), JPMSI will CEASE AND DESIST from
6 violating A.R.S. §44-1961(A)(13) in connection with the research practices referenced in this Order
7 and will comply with the undertakings of Addendum A, incorporated herein by reference.

8 3. Pursuant to A.R.S. § 44-1961(B)(1), JPMSI shall pay an administrative penalty in the
9 amount of \$395,321.00.

10 4. If payment is not made by JPMSI or if JPMSI defaults in any of its obligations set forth in
11 this Order, the Commission may vacate this Order, at its sole discretion, upon 10 days notice to
12 JPMSI and without opportunity for administrative hearing.

13 5. JPMSI agrees that it shall not seek or accept, directly or indirectly, reimbursement or
14 indemnification, including but not limited to payment made pursuant to any insurance policy, with
15 regard to all penalty amounts that JPMSI shall pay pursuant to this Order or section II of the SEC
16 Final Judgment, regardless of whether such penalty amounts or any part thereof are added to the
17 Distribution Fund Account referred to in the SEC Final Judgment or otherwise used for the benefit
18 of investors. JPMSI further agrees that it shall not claim, assert, or apply for a tax deduction or tax
19 credit with regard to any state, federal or local tax for any penalty amounts that JPMSI shall pay
20 pursuant to this Order or section II of the SEC Final Judgment, regardless of whether such penalty
21 amounts or any part thereof are added to the Distribution Fund Account referred to in the SEC
22 Final Judgment or otherwise used for the benefit of investors. JPMSI understands and
23 acknowledges that these provisions are not intended to imply that the Commission would agree that
24 any other amounts JPMSI shall pay pursuant to the SEC Final Judgment may be reimbursed or
25 indemnified (whether pursuant to an insurance policy or otherwise) under applicable law or may be
26 the basis for any tax deduction or tax credit with regard to any state, federal or local tax.

1 6. This Order is not intended by the Commission to subject any Covered Person to any
2 disqualifications under the laws of any state, the District of Columbia or Puerto Rico (collectively,
3 “State”), including, without limitation, any disqualifications from relying upon the State
4 registration exemptions or State safe harbor provisions. "Covered Person" means JPMSI, or any of
5 its officers, directors, affiliates, current or former employees, or other persons that would otherwise
6 be disqualified as a result of the Orders (as defined below).

7 7. The SEC Final Judgment, the NYSE Stipulation and Consent, the NASD Letter of
8 Acceptance, Waiver and Consent, this Order and the order of any other State in related proceedings
9 against JPMSI (collectively, the “Orders”) shall not disqualify any Covered Person from any
10 business that they otherwise are qualified, licensed or permitted to perform under the applicable
11 law of Arizona and any disqualifications from relying upon this state’s registration exemptions or
12 safe harbor provisions that arise from the Orders are hereby waived.

13 8. The Orders shall not disqualify any Covered Person from any business that they otherwise
14 are qualified, licensed or permitted to perform under applicable state law.

15 9. For any person or entity not a party to this Order, this Order does not limit or create any
16 private rights or remedies against JPMSI including, without limitation, the use of any e-mails or other
17 documents of JPMSI or of others regarding research practices, or limit or create liability of JPMSI, or
18 limit or create defenses of JPMSI to any claims.

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10. Nothing herein shall preclude Arizona, its departments, agencies, boards, commissions, authorities, political subdivisions and corporations, other than the Commission and only to the extent set forth in paragraph 1 above, (collectively, "State Entities") and the officers, agents or employees of State Entities from asserting any claims, causes of action, or applications for compensatory, nominal and/or punitive damages, administrative, civil, criminal, or injunctive relief against JPMSI in connection with certain research practices at JPMSI.

IT IS FURTHER ORDERED that this Order shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION

/s/ Mark Spitzer

CHAIRMAN

William A. Mundell

COMMISSIONER

Jeffrey Hatch-Miller

COMMISSIONER

Lowell Gleason

COMMISSIONER

IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Secretary of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this 24th day of September, 2003.

/s/ Brian C. McNeil

BRIAN C. McNEIL

Executive Secretary

Jim Irvin

DISSENT

DISSENT

This document is available in alternative formats by contacting Yvonne McFarlin, Executive Assistant to the Executive Secretary, voice phone number 602-542-3931, E-mail ymcfarlin@cc.state.az.us.

(PAH)

CONSENT TO ENTRY OF ADMINISTRATIVE ORDER BY
J.P. MORGAN SECURITIES INC.

J.P. MORGAN SECURITIES INC. hereby acknowledges that it has been served with a copy of this Administrative Order, has read the foregoing Order, is aware of its right to a hearing and appeal in this matter, and has waived the same.

J.P. MORGAN SECURITIES INC. admits the jurisdiction of the Commission, neither admits nor denies the Findings of Fact and Conclusions of Law contained in this Order; and consents to entry of this Order by the Commission as settlement of the issues contained in this Order.

J.P. MORGAN SECURITIES INC. states that no promise of any kind or nature whatsoever was made to it to induce it to enter into this Order and that it has entered into this Order voluntarily.

Paul W. Brandow represents that he/she is Chairman and President of J.P. MORGAN SECURITIES INC. and that, as such, has been authorized by J.P. MORGAN SECURITIES INC. to enter into this Order for and on behalf of J.P. MORGAN SECURITIES INC.

Dated this 25 day of August, 2003.

J.P. MORGAN SECURITIES INC.

By: /s/ Paul W. Brandow

Title: Chairman and President

SUBSCRIBED AND SWORN TO before me this 25th day of August, 2003.

/s/ Richard J. Carranza
Notary Public

My Commission expires:

2/6/07